1958

First National City Bank Monthly Letter

Business and Economic Conditions

New York, April, 1958

General Business Conditions

THE public, political, and press discussion of the business decline and measures to combat it has reached a crescendo, if not yet a climax, during March. Much of this Letter is devoted to the controversies which have emerged.

Paradoxically, argument is gathering momentum just at a time when the decline itself may be lessening in intensity. There is little doubt that March figures on unemployment will be up, and production and income down. Recent surveys confirm expectations of further declines in business spending and further hesitation by consumers, at least with respect to major items. On the other hand, the month-to-month change from February to March, in such key indicators as production, unemployment, and retail sales, seemingly has been less than in earlier months, and there are signs that any downward movement in April may also be more moderate. New claims for unemployment insurance have declined in March, and purchasing agents report little further decline in new orders. In part, slackening in the rate of decline reflects sizable adjustments already made, and therefore behind us, notably the curtailment of output in steel and other metals and resulting inventory liquidation. In part it reflects only seasonal tendencies and better weather.

A lessened rate of decline will not necessarily mean that the actual bottom of the recession is imminent. Adjustments in many lines, particularly capital goods, still have a long way to go. There is as yet no convincing evidence of a general upturn in orders, which would be a necessary forerunner of improvement in production and employment. Some individual firms or industries feel, however, that they are reaching for bottom. Certain appliance firms, metal producers, and machine tool and other machinery manufacturers report a slight improvement in orders, which may or may not hold. The best reason for thinking that the slope of the decline may be flattening is that production in many lines is clearly below consumption, which implies a slow restoration of market equilibrium.

The apparent drop in industrial production in March reflects further cutbacks in automobile, steel, and petroleum production. In February, the Federal Reserve production index (seasonally adjusted, 1947-49 = 100) dropped to 130, climaxing a fall of 10 per cent in five months. For the first time since the decline started, all major manufacturing and mining industries reporting in February were operating at a lower rate than a year earlier.

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Recessions Compared

The following table shows that in some respects the decline already has gone deeper than either of the two preceding mild recessions.

Among the dozen business indicators shown, three — industrial production, steel output, and new orders for manufactured goods — have already declined more than in either 1948-49 or 1953-54. The automobile and housing industries

Extent of Decline in Major Business Indicators in Postwar Recessions

Indicator (seasonally adjusted)	Per cent decline from high to low point in each series 1948-49	1953-54	1957-58*
Industrial production	10.5	10.2	11.6
Steel production†	32.2	36.0	42.0
Passenger car production	8.2	35.4	32.0
Housing starts	21.9	10.0	15.7
Nonagricultural employment	5.1	3.5	3.2
Manufacturing production workers	13.7	12.7	11.1
Personal income	4.9	1.4	1.6
Retail sales	4.1	5.9	4.9
New orders, manufacturing	18.3	16.9	22.8
Unfilled orders, manufacturing†	34.1	40.8	25.6
Inventories, manufacturing	10.4	7.4	8.1
Inventories, all business	6.6	5.5	1.4*

* Change through February '58 except for item starred, which is through January '58. †Not seasonally adjusted.

would also have done so had the declines been figured from their 1955 peaks instead of more recent highs.

The speed of the drop depresses sentiment. Yet there is another way of looking at it. Given the necessity of adjustment, the fact that the curtailment has proceeded rapidly may be favorable. At least some of the things that had to be done have been accomplished.

The inventory figures in the table look unfavorable and further liquidation is indicated. Nevertheless, comfort can be found in these figures also. The latest inventory statistics available run through February 28. By that time factory stocks had been cut, in six months, $1.7 billion. In the first two months of 1958, stocks were cut $1.0 billion, or an annual rate of about $6 billion. The rapid drop has doubtless continued. Precedents indicate that part of an inventory drop in recession, particularly in finished goods, occurs not during the declining phase of the cycle but in the early stages of recovery, when people begin to take goods off the market more rapidly than production is increased.

In a good many basic materials, production has been cut well below current consumption rates. Shortening of commitments by consumers, however, has deferred recovery in orders or production. Indications are mounting that in some lines this process has gone about as far as it can. The late Roy H. Glover, chairman of Anaconda Company, spoke not only for the copper industry but implicitly for many other suppliers when he said in March:

> This liquidation has been carried to the place that immediate delivery is now demanded of our fabricated products on nearly all orders, and many of our very important customers now freely say that their inventories are on the tail gates of our trucks.

In such a situation, any sizable revival in demand could touch off a flurry of ordering, intensified by desire for protective inventories against the lengthening of delivery schedules. On such snowballing demands are recoveries built. No convincing evidence that this process is starting, however, has yet appeared. Automobile manufacturers, under pressure of heavy dealer stocks and listless sales, have cut second quarter production schedules 8½ per cent below the first quarter rate. Advance orders for major defense items are now running above the spending rate, in contrast to the deep cut in backlogs during the first four months of this fiscal year. The lag between orders and expenditures, however, is a fairly long one.

Business Spending Prospects Down

A drop in demand for capital goods appears likely throughout 1958 and possibly into 1959, according to a survey during the first quarter by the Securities and Exchange Commission and the U.S. Department of Commerce. Business men are planning to cut plant and equipment expenditures in 1958 to $32 billion, down 13 per cent from the record 1957 total of $37 billion. The implied level in the second half of 1958 is nearly one fifth below the corresponding 1957 period. Even so, outlays in 1958 will be greater than in any previous year in the nation's history other than 1956 and 1957.

All major industries except public utilities are planning lower capital expenditures in 1958. In manufacturing, where an over-all cutback of 17 per cent is anticipated, outlays for new plant construction are scheduled to be one fourth less than in 1957, while purchases of machinery and equipment will be down about one eighth.

Consumers and Prices

Another survey, made about the same time by the University of Michigan, shows that consumers are somewhat more pessimistic and less inclined to make major purchases than they were a year ago. Yet in view of the rapid rise in unemployment, short work weeks, and curtailment of premium overtime pay, the volume of consumer purchases of goods other than automobiles has held up well. Demand is good if the price is right, as evidenced by the flurry of sales of small appliances following the end of "fair-trade" pricing in many lines during March.

Consumers are discouraged from buying when, as now, they consider prices too high, according to the Michigan survey. Considerable comment has been heard on the seeming paradox that retail prices keep on rising despite declines in production and employment. This is not a new phenomenon, for consumer prices averaged higher in 1954 than in 1953 despite a business recession, and also advanced in 1945-46 during the reconversion period.

If any lasting good is to come out of the current recession it might be an end to wage-price spiraling. Walter Reuther, referring to the continued up-trend in consumer prices, suggests that the law of supply and demand is no longer working. But there are two sides to the law. It is true that reduced demand should bring lower prices. On the other hand, increased costs bring higher prices. And costs, of which the most vital is wages, are still rising.

The UAW, of which Mr. Reuther is president, opened wage contract negotiations with the auto companies a week ago. The greatest contribution he could make to the improvement of the auto business and the economy would be to agree on a stand-still on wages, and let the manufacturer offer benefits of increased productivity to the consumer. The stimulus of a better deal to the buyer could create more jobs in the industry.

If, as trade union officials so often have argued, increased wages make prosperity, we should never have had this recession. For the bounty of wage advances these last years has rarely been richer. It is only when the manufacturer can pass them on in higher prices that the economy can accept higher costs and still prosper. But when the consumer objects—as he is objecting—profits are pinched and the merry holiday comes to an end. The recession in part represents a strike of consumers against inflation. Health and recovery will come sooner if manufacturer and trade union leader alike give heed and recognize the mandate of the market.

Proposals for Government Action

Contrasting with the moderation of the business recession is the excitement stirred among political leaders. This reflects feelings that, unless effective government actions are taken, the best the economy can do is to flounder along with a chronic unemployment problem. Counselling delay was the consideration that actions already taken, or resilience of the economy and the people, might bring the desired revival. Lurking in the background was the memory of the Lost Decade, 1930-40, when an overabundance of government projects to restore prosperity gave us the longest depression in our history.

It may not be inappropriate to quote President Truman's calm comment on February 15, 1950 when unemployment was reaching the highest level in nine years. Mr. Truman stated, according to Arthur Krock of the *New York Times*:

> A certain amount of unemployment, say from three to five millions, is supportable. It is a good thing that job-seeking should go on at all times; this is healthy for the economic body.

Nevertheless, the present political concern shows the weight of responsibility the Federal Government has assumed for high-level production and employment. Since the bulk of job opportunities in our society are provided by private employers, the most acute need is to understand the incentives which lead enterprising people to offer employment opportunities and the price-cost relationships which permit production and sale at a profit. Instead of thinking of profits as something undesirable, the Congress must conjure up means of reviving them. Increased employment and tax revenues will follow in due course.

All during the month of March, Washington was rife with rumors of impending actions and legislative proposals of various sorts. The atmosphere was one in which almost any foolish expedient might have been enacted if the support of the President had been forthcoming. But the President, while in almost constant consultation on proposals for meeting the recession, refused — as he put it — "to be panicked by alarmists into activities that could actually make [the hardships of unemployment] not temporary but chronic." At the same time he emphasized that:

> This Administration will continue to undertake, by executive action or proposal to the Congress, any measure — including tax reduction if, after consultation with Congressional leaders, such action should prove desirable and necessary — that will assist healthy economic recovery.

No one should have any desire to shoot us off on another inflationary binge. That is one real danger. The opposite danger is that timely action of the right sort will bog down in partisan wrangling. According to a *Wall Street Journal* report, George Meany, president of the AFL-CIO, has characterized the situation as one in which "the Democrats know they can make political capital out of talking about the recession and doing little about it" while the Republicans hope to protect themselves by hiding the fact that "the economy has become dangerously sick."

It will only be by sacrifice of selfish political advantage, and attention to realities, that a foundation can be laid for a sound and enduring recovery.

Actions So Far

The most dramatic actions so far have been taken by the Federal Reserve System. The Reserve Banks' discount rates, 3½ per cent up to November 14, have been cut in a succession of steps to the prevailing 2¼ per cent. Effective March 20 and April 1, the Federal Reserve Board, for the second time in two months, released $500 million from the cash reserve re-

quirements of the banks. With this help the banks have been largely relieved of needs to borrow from the Federal Reserve and are made more receptive to loan and investment opportunities. While borrowings by business and consumers have moderated, those of government – federal, state and local – are rising as a result of weakened revenues and increased outlays.

Support is being given to the economy from the side of easier credit availability. Other actions taken include a succession of measures to spur homebuilding, a step-up in defense ordering, and an acceleration of previously programmed public projects. For example, outlays are being increased for water resources and reclamation, urban renewal, hospital construction, modernization of postal facilities, and improvements of federal buildings. Congress is acting to raise the spending targets on highway programs.

Also, in the name of countering recession, the Congress passed a bill retaining high price supports for milk, butterfat, wheat and seven other farm commodities. The President, in vetoing the bill, pointed out the folly of piling up more farm products in Government warehouses. There is neither mercy nor sense in government actions to hold up food costs when millions of people are suffering financial strain.

Federal Spending versus Tax Relief

All kinds of ways to stimulate the economy with tax relief have been suggested. Early in March indications were that bipartisan agreement was forming on a $5 billion tax cut "across the board" with primary emphasis on the personal income tax but including also the corporate income tax and some excise taxes. But the decision emerged to wait and give the matter another look in 30 or 60 days.

Two schools of thought opposed any consideration of tax reduction: conservatives fearful of inflationary consequences and "neo-liberals" anxious to prosecute ambitious new social programs.

Of course, anybody, legislators included, feels a reluctance to give up revenues. On the other hand, if taxes are not to be reduced, increased federal spending proposals become the order of the day.

The President on March 25, after discussions with State governors, proposed federal aid to prolong unemployment benefits. Employers, who pay the costs of unemployment insurance, would stand the costs on a deferred basis. Pressure developed too to increase unemployment benefits. In considering these ideas it should never be forgotten that, given the human proclivity for leisure, there is no easier way to make unemployment a permanent problem than extending and enlarging unemployment pay. It must be borne in mind that public assistance programs stand behind unemployment insurance where there is genuine need and no shirking from job opportunities.

Senate Majority Leader Lyndon Johnson of Texas advocated a "One-Package Prosperity Bill" which would feed out more federal money via increased old-age pensions and unemployment compensation with a tax cut as a possible addition.

Another idea, advanced by Senator William Fulbright of Arkansas and Congressman Brent Spence of Kentucky, is to try to stimulate spending of States and municipalities by offering them $2 billion in 50-year loans at 3 per cent to finance streets, sidewalks, roads, bridges, waterworks, parking lots, recreational facilities, hospitals, sewers, schools, libraries, etc. The curiosity of this proposal is the absence of any manifest need. States and municipalities are already borrowing record-heavy amounts – about as much indebtedness as they can handle and as taxpayers will approve – at rates comparing favorably with Federal Government borrowing costs.

Of course if the federal funds came "for free" many municipalities would be glad of the opportunity to reduce local taxes.

Closer to the area of practical need were projects to save railroads from the threat of bankruptcy or to help them buy needed equipment, though relief from overtaxation and competitive handicaps were recognized as more basic cures.

Public Works et Cetera

The biggest spending proposals, however, originated with advocates of public works et cetera. On the model of "the New Deal" of a generation ago, Senator Albert Gore of Tennessee recommended, besides acceleration of the going highway program, establishment of a new Public Works Administration with an initial appropriation of $500 million. Senator Jacob Javits of New York, belittling the usefulness of tax cuts, urged a $4 to 5 billion federal anti-recession program of public works, aid to education, and actions to boost the housing industry. Other voices joined in support of a multi-billion "crash" public works program as an alternative to tax reductions.

The prescription of bigger federal spending for almost everything fits the "Harvard view" for which Professor Kenneth Galbraith, chief economic adviser to the Democratic National Committee, and Professor Arthur Schlesinger, Jr.,

a vice-chairman of the Americans for Democratic Action, are leading spokesmen. Professor Galbraith objects to cutting taxes because it will be so hard to raise them again, because it will initially help people who are already working, and because it will create controversy as to what taxes are to be reduced how much.

To be sure, a great public works program will threaten higher taxes than we already have, will initially help an industry (construction) that is already working at a record level, and will certainly "create controversy" as to what projects should be undertaken where. It may also be worthy of note that pouring much more money into construction will spur the construction cost inflation that has been running 5 per cent a year compounded for more than a decade.

Professor Schlesinger, distrusting the judgment of a free people, assumes that money released by tax cuts would be used to buy "more automobiles, fine television sets and the like" and calls it "the height of folly to dissipate the money released through governmental deficits in consumer spending instead of using it to do things for our nation that desperately need to be done" – "more schools, roads, hospitals, housing, national defense, foreign aid."

Of course, there are other uses people make of money besides buying more automobiles and fine television sets. They feed and clothe growing families, contribute to colleges and charities, and pay record-high local taxes for schools and roads and hospitals.

Professor Galbraith would omit increased defense expenditures as a use for idle manpower but otherwise has about the same indefinitely long catalog of "urgently needed public activities." When business picks up, he states, outlays for these purposes can be stretched out and tapered off.

In mid-March Congress passed joint resolutions commending accelerated expenditure of funds previously appropriated for civil and military public works. But the Democratic majority in the Congress so far has not displayed great enthusiasm for attempting to attract more people off the unemployment rolls and away from other industries into the construction trades. Senator Paul Douglas, a former professor of economics at the University of Chicago, favors tax reduction for lower and middle-income groups over public works spending. While expressing himself as "not opposed to the expansion of needed public works in periods of economic recession," he points out that "major projects would be very slow in actually being started" and that "even those projects which can begin early will not necessarily be in the localities where the major portion of the unemployment exists."

Irreversibility of Government Expenditures

In his book, *Economy in the National Government*, published in 1952, Senator Douglas dealt with the more general proposition, "that governmental expenditures are like electric lights which can be turned off or on at will":

> In real life this is not so. There tends instead to be a systematic bias in favor of expanding expenditures and against contracting them. This is true for several reasons.
>
> In the first place, it is hard to get projects for which the period of expenditure precisely coincides with that of the depression. Prosperity frequently comes before the construction job is completed. This is particularly true of huge public works.
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> Second, people acquire a vested interest in government work projects. Projects started in periods of depression result in hiring many governmental employes. These men and women like their jobs. They believe in the worth of their projects; they come to think of them not as measures to get us out of the depression but as essential parts of the national life. So they insist on holding on to them even though their original justification has disappeared. To stop these projects would mean that the employes might lose their jobs and be thrust out into a harsh and cruel world.
>
> So officialdom tends to line up in support of these projects in good as well as bad times.
>
> Third, there are those who furnish the materials or benefit from the services supplied. It is quite touching to witness the enthusiasm which is felt by the producers of cement for the public roads and dams of this country. Similarly, the producers of bricks, lumber, electrical fixtures, and plumbing fixtures ardently want a big volume of housing, preferably under private auspices, but still a big volume of housing. High military expenditures also bring about this type of vested interest.
>
> Once the government starts a program of expenditures, it builds up tremendous pressure groups. These groups resist having the programs turned off in the automatic way that economists prescribe.

The record shows that the only times public works and government spending get cut back is when people insist on lower taxes.

In a speech on March 18 President Eisenhower referred to "the make-work approach with its vast, slow-moving projects":

> To this I am flatly opposed. First, it is not effective. Moreover, experience clearly shows that too much of this sort of make-work activity tends to supplant rather than to supplement private activity. It dulls the edge of private initiative. It builds up a huge bureaucracy. And it threatens to turn a temporary recession into a long-term economic headache.

This is a lesson we ought to take to heart out of the Great Depression. Billions upon billions spent by the Federal Government to make jobs still left 10,000,000 on the unemployment rolls.

The real solution to unemployment lies in the encouragement — not in the displacement — of private enterprise. It is the products of private enterprise, bought with the citizen's precious take-home pay, that make the high American living standard.

Debate on Taxes

The debate on taxes has developed many points of view. Some divide a tax cut of $5 billion by our 173,000,000 population and get an answer of $28.90 per capita which they disparage as "a few cents a week." What this proves if it proves anything is that a per-capita tax cut is no way to go about the business. The income tax is not a poll tax. It is a tax on work and enterprise. No employer can hire an extra man or buy an extra machine out of a $28.90 tax cut. But a tax cut of $2,890 can enable a private employer to add a man to his payroll cheaper than the government can — and out of locally available manpower. Indeed it may give him the credit base and incentive to raise money and hire five or ten men.

Others object that any tax reduction will be used only to pay off debt or accumulate savings. But if people are so overloaded with debt, or so frightened about the future, strengthening of their cash positions and confidence becomes necessary before recovery can begin.

More generally, however, it is assumed that a tax cut can have a powerful stimulating effect in proportion to its amount, type and permanency.

There are infinite possibilities for modifying taxes. For about $3 billion, for example, it would be possible to increase the personal income tax exemption from $600 to 700; or cut all personal income tax rates 8 per cent; or reduce the corporate tax rate 7 points to 45 per cent. In terms of excise taxes, $3 billion slightly exceeds the revenues received on alcohol, though most commonly discussed are reductions in the 3 per cent excise on transportation of property which yields some $470 million, the 10 per cent excise on passenger cars and parts which yields $1.3 billion, and the 10 per cent excises on various other consumer goods which yield some $630 million.

The Sadlak-Herlong plan for reforming the income tax rate progression over five years is the best bargain. For no greater calculated revenue loss the first year, it would provide stimulation to forward-looking enterprise from successive further reductions in the years ahead. The object would be to obtain equal or greater revenues from a more reasonable structure of rates.

Excise Taxes

Excise tax reductions tend to reduce prices of items affected. Those of broadest impact are the transportation taxes; they get loaded into the price of almost everything and are a particular burden to the railroads in their competition with private trucks and passenger cars.

While it might be politically popular to cut excise taxes to cheapen by a few per cent the prices of selected consumers' durable goods, there are serious objections from the revenue standpoint. Excises represent a core of comparatively stable revenues. Apart from alcohol and tobacco taxes, reductions of rates from present levels would do rather little to stimulate business and the revenues. In other words, revenue loss would tend to be permanent.

For example, the value of cars sold would need to double for a 5 per cent excise tax on passenger cars to develop as much revenue as the 10 per cent rate does now. This is most unlikely. To get back lost revenues one would have to figure on getting the recovery out of higher income tax collections. But if we pursued this sort of reasoning we would soon have only income taxes left.

From the opposite point of view, individual income tax reduction could leave people more to spend and thus improve excise tax collections.

There has been some discussion of a 2 point reduction, to 50 per cent, in the corporate income tax rate. A 5 point reduction has been scheduled by law ever since 1954 but has been postponed year after year. Our standard corporate rate, the highest in the world, requires a growing manufacturer to see returns on investment such as 30 or 40 per cent before tax to justify new capital investment.

Lowering the tax can make lesser rates of return economical and reinforce investment for progress. In the immediate situation it can relieve the cost-price pinch under which industry is laboring and avoid needs to raise prices. This is because the corporate income tax is embodied in business costs and prices. In other words, like excise tax cuts, corporate tax reduction would help hold prices down. Unlike excise tax cuts, it would help tighten business efficiency. But it cannot be reduced rapidly without important losses of revenue, for the benefits of reduction, if not used to absorb higher costs, would tend to be passed on to consumers.

The Personal Exemption

The permanent revenue loss angle becomes involved most seriously when people talk of raising the personal income tax exemption from the present $600 to 700 or even $800. The idea

in this approach is that economic activity is geared up to consumer expenditures. The philosophic basis is that poor people (defined as those paying the least income tax) should pay no income tax; that government should be financed by the rich for the benefit of the poor.

But if the rich are going to pay enough additional taxes to make up the revenue loss they will have to reap record heavy profits. Here the steep rate progression steps in to deny opportunity to accumulate wealth through taxpaying enterprise. What wealth builds up accumulates outside the personal income tax structure.

Thus the loss of revenue from exemption increase can be made up in the final analysis only by inflation — that is by raising prices and incomes to a point where $700 or 800 represents no more real buying power than $600 does now.

We could get a strong inflationary spurt but no lasting benefit. In fact, the progression of rates would become even more onerous. One of the most insidious effects of inflation is the way it burdens industry with increased costs of capital replacement and at the same time tightens the noose on private capital formation.

It is only reform of the progression of rates that offers opportunity for quick revenue recovery out of tax rate cuts. Personal income tax revenues flourish when rates are pruned. In fiscal 1956, two years after the 1954 tax cuts, personal income tax revenues were higher than ever before.

This is because the progression of rates runs beyond the point of diminishing return, turning the efforts of some of our smartest people from developing taxable income to minimizing tax.

It is a pity that the Government spent its increased revenues during the last two years of the boom, 1956-57. We could have been prepared to cut taxes within a balanced budget. Now when cuts are needed the budget is in the red.

Further increases in expenditures, and declining revenues, have already created a federal deficit. The only sensible reason for considering action on taxes at all is that there are patterns of tax action that can restore the prosperity of the nation and, with a reversal of the trend of government expenditures, also restore a balanced budget.

A Temporary Cut?

If we are not careful we may escape recession into the jaws of inflation — the chronic problem of the postwar decade. This fear is responsible for the numerous suggestions that a tax cut should be temporary, running anywhere from a few months to a year. The benefits of a total tax forgiveness for only a few weeks could cost more than $5 billion. The effects, one might guess, would resemble those of the veterans' bonus payment back in 1936: a temporary bulge in retail trade followed later on by higher taxes and renewed slump.

The influential Committee for Economic Development two weeks ago advanced for consideration a plan for a 20 per cent cut in personal income taxes effective perhaps July 1 and to run until March 31, 1959. In calendar - year terms such a cut would give a discount of 10 per cent on personal income tax for 1958 and 5 per cent for 1959. The annual revenue loss is put at $7 to 7½ billion.

The longer a tax cut runs the more enduring its stimulating usefulness. Best of all is permanent reform which, with rapid curtailment of emergency expenditures, can provide revenues to overbalance the budget in prosperous years.

The 17 Democrats constituting New York's delegation to the House of Representatives have caught the right idea. They issued a statement March 23 which said:

> We believe that tax reform is long overdue. . . . During this recessionary period it is not only a wise policy, it is required to restore health to the economy.

This group favors — besides income tax cuts on a broad base — allowance of greater deductions, especially to small business and professional people, in calculating tax liabilities. If enough deductions can be provided to one and all, of course, the rates lose their teeth. It has been by giving people and industry escapes from the rate structure that we have been able to get along so far. But, since these escapes have been granted selectively, to take care of the problems of particular groups or even individuals, the whole of the structure is shot through with inequities.

Some people have gone so far as to say that the progression of personal income tax rates in many instances has become meaningless. The AFL-CIO's *Labor's Economic Review* for February racks up a total of $9.1 billion annual revenue loss to the Treasury from what it calls "tax avoidance devices":

> While our income tax structure still retains a schedule of progressive tax rates from 20 to 91 per cent, the higher rates in many instances have become meaningless. They simply provide a facade of progressive taxation to hide the fact that upper-income taxpayers utilize a variety of tax avoidance devices to reduce substantially the impact of these scheduled rates.

The removal of $9.1 billion tax relief provisions could create scales of unemployment unknown

even in the Great Depression. But, if the AFL-CIO is ready to discard the income tax rate progression, a challenging proposition emerges: repeal "tax avoidance devices" and create a flat 18 per cent personal income tax rate without any deductions.

The best available estimate of the revenues from the income tax rate progression, prepared by the National Association of Manufacturers, is between $5 and 6 billion. If the figure of $9.1 billion for revenue losses from "tax avoidance devices" is accurate, there would be enough money left over to raise the personal exemption to the $700 the AFL-CIO advocates.

The AFL-CIO does not label the personal exemption as a "tax avoidance device" though it can have that nature, especially in the way the law applies it. The aged and blind are given double exemptions and so also, in practical effect, are dependents who may be of working age. Under a $700 personal exemption, for example, a family with five children conceivably could have an income as high as $9,333 – near double the national average – without paying federal income tax. (Tax exempt unemployment compensation could build the figure even higher.) A single individual with $9,333 income would have to give up $1,870 in federal income tax.

If the personal exemption were pushed up to $800, as some suggest, the family with five children could make as much as $10,666 without any federal income tax liability; the single person with this income would be called upon to pay $2,254. Here too are inequities in the tax structure.

Stimulate Business Spending

The best approach to the relief of unemployment is to stimulate business spending instead of consumption spending. David J. MacDonald, president of the United Steelworkers, advocates this course as do most business and manufacturers' associations. Mr. MacDonald suggests the offer of some inducement to the business community to keep plant and equipment buying at a high level and thinks there should be a committee appointed to "design a system of incentives for business." The obvious way to accomplish this object is via tax rate reforms.

The objection is raised that goods and plant capacities are already abundant. This is true with most goods of familiar types. But we need funds and imaginative energy released to design and manufacture products now unknown as a basis for a progressive economy and world leadership. The capacity to produce horse-drawn buggies was abundant when the Model T Ford was invented.

The really crucial problem is the personal income tax progression which does not stop until a 91 per cent rate has been reached. Needless to say, few people expose any income to taxation at this rate, but the whole progression stifles the accumulation of risk capital necessary to launch and build new enterprise. Small investors, in their common stock investments, favor established business with a substantial record of success. The same is true of mutual funds and trusteed pension funds. The key difficulty is that of the individual enterpriser trying to accumulate risk capital and go ahead on his own or to find others able to risk capital in blocks of $10,000 and 25,000. The vanishing American is the citizen with money to stake risky, tax-paying enterprise.

We have many great enterprises – founded and expanded when income taxes were much lower or nonexistent. A few large enterprises have emerged more recently by the route of mergers or with the special help of government contracts and accelerated amortization of facilities. But finding people with money to risk, in order to finance a new idea, is difficult. And those who found a new firm find the tax gatherer waiting on the threshold of success to take the bulk of the money that could be plowed back into tools and machinery to provide employment for workers and desirable new products for the public at large.

Sixteen thousand dollars is a modest sum as capital requirements of business go. A single worker may use tools and machinery of this value. Yet beyond this taxable income level the individual income tax demands half or more. If the tax were easier and the business could grow the tax collector could get more revenues from a lower rate on a higher taxable income base. And the Government could be spared the expense of appropriating money to lend to risky, small enterprises.

A Critical Choice

The weakest argument against a tax cut is that the subject is controversial and hence should be ignored. No business man, no nation gets anywhere failing to look problems in the face.

It is true that this Congressional election year is a poor time to expect statesmanlike action on taxes. Each party would like credit for a tax cut. Each might like to deride the other for favoring "the entrenched big business interests" and neglecting "the little fellow." Yet an unemployed worker has more to gain from a reduction in business taxes that brings him a job than from an exemption increase to people already employed. The economy gains, too, from his pro-

duction. His product and paycheck balance off in the market, minimizing inflationary pressure.

Tax reduction is more than a matter of releasing some billions of dollars of buying power into the markets. It makes a world of difference what taxes are changed. Tax rates enter into every business calculation of costs, prices, prospective markets and prospective means for financing expansion, production and employment. Out of tax reduction we can reap an inflationary whirlwind. Or we can regenerate long-range business optimism.

What Congress needs above all in dealing with taxes is imagination and respect for the importance to enterprise of a favorable tax climate and a stable money. This is what we tell nations abroad that want to develop. It is time we applied the advice at home.

Corporate Earnings in 1957

Additional reports for the year 1957 issued during March by some 1,000 companies confirm the pattern indicated by our preliminary summary of earnings given last month, both as to annual changes and the fourth quarter drop. Annual statements now published by 3,521 companies representing all major lines of business show for the year as a whole combined net income after taxes of $19.6 billion, an increase over 1956 of 1 per cent. A summary by major industry groups is given on the next page.

Sales or revenues last year of all reporting companies, excluding the financial groups, aggregated approximately $290 billion, upon which the combined net income after taxes represented an average net profit margin of 6.1 cents per dollar of sales. This was slightly below the 6.3 per cent in 1956. Among the 60 nonfinancial industry subgroups, average net profit margin was narrower than in the preceding year in 45, wider in 9, and unchanged in 6.

Book net assets or net worth of all the reporting companies, including finance, aggregated $185 billion at the beginning of 1957, upon which the year's net income represented an average return of 10.6 per cent. This was moderately below the 11.3 per cent average return in 1956 on book net assets of $171 billion. Among the major industry subgroups, average return last year was lower in 50, higher in 13, and unchanged in 2. These companies, whose financial reports available in the newspapers and investment manuals are included in our tabulation, represent something over 50 per cent of the book net assets of all U.S. corporations.

Trends in Manufacturing

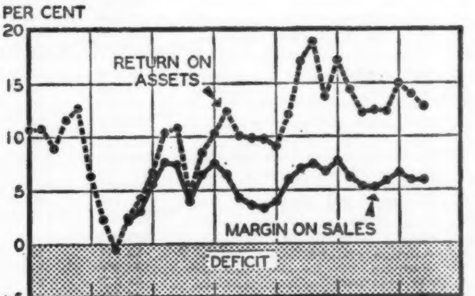
Figures for the fourth quarter now available from 970 manufacturing companies show that combined net income was 14 per cent below that of a year earlier and that the drop largely wiped out gains registered earlier in the year. The following table shows the preponderance of declines by industry groups:

Net Income of Leading Manufacturing Corporations for the Fourth Quarter, 1956-1957

(In Thousands of Dollars)

No. of Cos.	Industry Groups	1956	1957	% Chg.
49	Food products	$ 93,550	$ 94,198	+ 1
25	Beverages	42,444	40,938	— 4
14	Tobacco products	45,910	48,331	+ 5
53	Textiles & apparel	48,648	34,606	—29
15	Tires, rubber products	59,707	45,752	—23
47	Paper & allied products	97,075	87,194	—10
48	Chemical products	248,657	222,824	—10
32	Drugs, soap, cosmetics	89,265	109,049	+22
73	Petroleum prod. & ref.	839,744	697,559	—17
68	Cement, glass, stone	119,158	110,702	— 7
46	Iron & steel	351,759	242,265	—31
36	Building, heat. equip.	33,244	28,772	—13
47	Electrical equipment	104,158	112,505	+ 8
79	Machinery	106,646	66,146	—38
19	Office equipment	37,672	44,372	+18
28	Nonferrous metals	154,014	90,782	—41
40	Instruments, photo gds.	70,165	60,479	—14
92	Other metal products	96,869	85,119	—12
45	Automobiles & parts	371,249	358,064	— 4
45	Other transport. equip.	126,799	113,644	—10
69	Misc. manufacturing	76,087	62,580	—18
970	Total manufacturing	$3,212,820	$2,755,831	—14

Manufacturing earnings over the longer term are pictured in the accompanying chart, based on our previous annual tabulations in the April issues of this *Letter*.



Annual Average Net Profit Margins on Sales and Rates of Return on Book Net Assets of Leading Manufacturing Corporations

In 1957 the average net profit margin of these manufacturing companies was 5.9 per cent on sales and other income, against 6.0 in 1956. Last year's margin was slightly above the average over the 25-year period 1933-57 of 5.6 per cent.

Rate of return on book net assets in manufacturing last year of 12.8 per cent was down from 13.8 per cent in 1956, reflecting the virtually unchanged total of net income but the addition of $8 billion to net assets. Last year's return was slightly above the average for the 25 years 1933-57 of 11.3 per cent.

NET INCOME OF LEADING CORPORATIONS FOR THE YEARS 1956 AND 1957

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1956	Reported Net Income After Taxes 1957	Per Cent Change	Book Net Assets Jan. 1-a 1956	Book Net Assets Jan. 1-a 1957	% Return on Net Assets-a 1956	% Return on Net Assets-a 1957	% Margin on Sales-b 1956	% Margin on Sales-b 1957
18	Baking	$ 60,641	$ 65,388	+ 8	$ 496,285	$ 518,631	12.2	12.6	3.3	3.4
11	Dairy products	98,432	102,266	+ 4	791,753	848,182	12.4	12.1	2.6	2.5
14	Meat packing	64,051	37,698	—41	843,938	885,414	7.6	4.3	0.9	0.5
23	Sugar	40,339	55,997	+39	610,114	632,146	6.6	8.9	3.7	4.9
88	Other food products	346,257	350,016	+ 1	2,949,865	3,100,138	11.7	11.3	4.2	3.9
15	Soft drinks	47,498	48,696	+ 3	331,064	343,714	14.3	14.2	*	*
21	Brewing	27,531	26,627	— 3	358,922	368,008	7.7	7.2	3.3	2.5
10	Distilling	80,276	87,587	+ 9	1,168,954	1,202,204	6.9	7.3	3.0	3.6
20	Tobacco products	175,182	192,094	+10	1.449,706	1,510,099	12.1	12.7	5.1	5.2
72	Textile products	183,339	168,194	— 8	2,725,543	2.865,751	6.7	5.9	3.6	3.1
49	Clothing and apparel	33,314	29,898	—10	428,275	450,115	7.8	6.6	3.2	2.9
25	Shoes, leather, etc.	41,998	45,456	+ 8	388,332	421,966	10.8	10.8	3.3	3.4
24	Tires, rubber products	229,773	225,856	— 2	1,669,140	1,822,765	13.8	12.4	4.5	4.4
26	Lumber	134,331	106,210	—21	1,064,624	1,160,858	12.6	9.1	8.6	6.9
18	Furniture, wood products	33,064	25,712	—22	238,394	245,949	14.2	10.5	5.2	4.4
67	Paper and allied products	444,287	374,702	—16	3,130,064	3,474,462	14.2	10.8	8.0	6.9
42	Printing and publishing	69,081	78,060	+13	500,555	541,454	13.8	14.4	5.2	4.9
69	Chemical products	984,247	967,209	— 2	6,355,090	6,908,642	15.5	14.0	9.1	8.5
24	Drugs and medicines	220,877	264,895	+20	1,006,457	1,108,640	21.9	24.0	11.9	11.7
20	Soap, cosmetics, etc.	104,812	121,340	+16	631,235	682,825	16.6	17.8	5.1	5.5
21	Paint and varnish	105,418	104,681	— 1	584,693	660,079	18.0	15.9	6.9	7.0
116	Petroleum prod. and refining	3,147,799	3,239,562	+ 3	21,529,835	23,811,998	14.6	13.6	10.4	9.7
30	Cement	132,328	115,799	—12	642,847	729,983	20.6	15.9	16.4	15.5
18	Glass products	165,660	166,547	+ 1	935,557	1,087,244	17.7	15.3	8.3	8.1
53	Other stone, clay products	215,894	203,635	— 6	1,350,286	1,528,163	16.0	13.3	8.9	8.3
55	Iron and steel	1,105,355	1,152,080	+ 4	7,948,028	8,731,836	13.9	13.2	7.2	7.4
10	Agricultural implements	148,055	129,945	—12	1,786,812	1,882,312	8.3	6.9	4.8	4.1
76	Building, heat., plumb. equip.	155,821	141,613	— 9	1,378,520	1,466,923	11.3	9.7	4.6	3.9
97	Electrical equip., radio & tv	500,990	617,543	+23	4,243,290	4,502,918	11.8	13.7	3.7	4.2
48	Hardware and tools	65,079	60,216	— 7	539,094	581,411	12.1	10.4	6.3	5.9
31	Household appliances	80,323	64,980	—19	634,159	649,608	12.7	10.0	4.7	4.0
160	Machinery	873,146	869,750	— 1	2,459,377	2,751,439	15.2	13.4	6.2	5.7
27	Office equipment	145,520	164,163	+13	833,149	938,689	17.5	17.5	6.6	6.4
45	Nonferrous metals	679,553	430,160	—37	3,958,754	4,899,978	17.2	9.8	10.5	7.9
77	Instruments, photo. goods, etc.	227,222	230,560	+ 1	1,391,066	1,579,977	16.3	14.6	7.2	6.5
111	Other metal products	291,172	276,326	— 5	2,334,044	2,494,578	12.5	11.1	4.3	4.1
14	Autos and trucks	1,071,151	1,259,718	+18	7,314,035	7,691,275	14.6	16.4	5.7	5.7
51	Automobile parts	160,789	164,167	+ 2	1,247,849	1,378,784	12.9	11.9	5.0	4.9
20	Railway equipment	95,769	103,894	+ 8	965,792	1,018,490	9.9	10.2	4.4	4.4
41	Aircraft and parts	337,152	374,277	+11	1,574,347	1,857,760	21.4	20.1	3.4	3.0
78	Misc. manufacturing	169,484	159,835	— 6	1,609,526	1,714,784	10.5	9.3	4.6	4.0
1,835	Total manufacturing	12,793,010	12,902,852	+ 1	92,394,370	100,544,682	13.8	12.8	6.0	5.9
20	Coal mining - c	80,204	80,841	+ 1	788,534	873,795	10.2	9.3	7.2	6.3
29	Metal mining - c	93,289	51,858	—44	611,444	656,847	15.3	7.9	10.8	6.1
10	Other mining, quarrying - c	53,408	41,778	—22	243,926	265,682	21.9	15.7	22.2	19.2
59	Total mining, quarrying	226,901	174,477	—23	1,643,904	1,796,324	13.8	9.7	10.3	7.6
84	Chain stores — food	130,714	150,417	+15	850,425	954,030	15.4	15.8	1.4	1.4
57	Chain stores — variety, etc.	140,508	137,193	— 2	1,420,030	1,479,582	9.9	9.3	3.3	3.1
63	Department and specialty	201,186	205,991	+ 2	1,931,670	2,042,150	10.4	10.1	2.9	2.8
6	Mail order	208,329	201,138	— 3	1,748,671	1,852,055	11.9	10.9	4.2	4.0
68	Wholesale and misc.	95,291	90,248	— 5	840,894	894,363	11.3	10.1	2.0	1.9
228	Total trade	776,023	784,987	+ 1	6,791,690	7,222,180	11.4	10.9	2.6	2.5
113	Class 1 railroads - d	879,002	733,998	—16	16,561,482	16,562,140	5.3	4.4	8.3	7.0
28	Traction and bus	25,117	23,726	— 6	442,020	428,379	5.7	5.5	3.6	3.4
12	Shipping	49,964	53,371	+ 7	409,412	442,829	12.2	12.1	9.3	7.9
13	Air transport	69,577	34,514	—50	513,634	599,565	18.5	5.8	4.1	2.2
47	Misc. transportation	47,166	47,175	+—	369,406	412,499	12.8	11.4	6.4	5.0
218	Total transportation	1,070,826	892,784	—17	18,295,954	18,445,412	5.9	4.8	7.5	6.2
249	Electric power, gas, etc. - d	1,686,382	1,792,878	+ 6	16,797,958	18,078,075	10.0	9.9	13.7	13.4
29	Telephone and telegraph - d	874,555	956,554	+ 9	9,272,009	10,706,530	9.4	8.9	13.2	13.2
278	Total public utilities	2,560,937	2,749,432	+ 7	26,069,967	28,784,605	9.8	9.6	13.5	13.3
23	Amusements	53,704	45,717	—15	668,816	715,493	8.0	6.4	4.6	3.1
29	Restaurant and hotel	24,588	21,852	—11	214,718	234,175	11.5	9.3	3.9	3.3
41	Other business services	115,545	122,960	+ 6	538,455	631,305	21.5	19.5	7.5	7.5
23	Construction	37,157	46,677	+26	256,170	284,052	14.5	16.4	4.0	3.4
116	Total amusements, services, etc.	230,994	237,206	+ 3	1,677,654	1,865,025	13.8	12.7	5.4	4.6
390	Commercial banks	884,880	971,342	+10	8,921,805	9,622,974	9.9	10.1	—	—
62	Fire and casualty insurance	81,833	65,629	—20	3,545,865	3,571,371	2.3	1.8	—	—
205	Investment trusts - e	478,549	522,772	+ 9	9,971,400	11,236,483	4.8	4.7	—	—
72	Sales finance	229,697	244,069	+ 6	1,410,817	1,543,649	16.3	15.8	—	—
68	Real estate	13,791	14,264	+ 3	160,422	169,881	8.6	8.4	—	—
797	Total finance	1,638,750	1,818,076	+ 8	24,009,809	26,144,358	7.0	7.0	—	—
3,521	Grand total	$19,347,446	$19,559,814	+ 1	$170,883,348	$184,802,586	11.3	10.6	6.3	6.1

a—Book net assets at the beginning of each year are based upon the excess of total balance sheet assets over liabilities; the amounts at which assets are carried on the books are far below present-day values. b—Profit margins computed for all companies publishing sales or gross income figures, which represent about nine-tenths of total number of reporting companies, excluding the finance groups; includes income from investments and other sources as well as from sales. c—Net income is reported before depletion charges in some cases. d—Due to the large proportion of capital investment in the form of funded debt, rate of return on total property investment would be lower than that shown on net assets only. e—Figures in most cases exclude capital gains or losses on investments. *—Not computed because of limited number of sales figures available for the group.

Limitations to Earnings Comparisons

Although the percentage rates of profit on sales and return on net assets are widely used in the measurement of business earnings, there should be kept in mind numerous limitations to the strict comparability of these ratios as between different companies, different industries, and different periods of time.

In the measurement of earnings, a change in dollar net income from one period to another needs to be related to the volume of business handled or the capital employed.

Net profit per dollar of sales — the simplest ratio for the measurement of earnings — shows what portion of the value of the product or service is retained by the producer or dealer, after deduction of operating expenses, available for payment of dividends or to plow back for expansion. Profit margins, however, vary widely depending on the rate of capital turnover and therefore are not comparable as between different lines of business.

Return on "Book Net Assets"

For comparing earnings in all lines of business the only common denominator is return on capital. In our tabulation we use the total of "equity capital," also spoken of as "book net assets" or "net worth" or "capital and surplus." Rates of return should be adequate to generate from within or attract from without the new capital needed constantly for replacement and growth.

Book net assets are not, in the case of most companies, a fully reliable measure of the present-day value of assets. This is due principally to the fact that balance sheet valuations of land, plants, and equipment are customarily based on historical costs, less depreciation, which in most cases are substantially below replacement costs because of sharp advances in wages and materials.

As time goes on, this discrepancy between book values and replacement costs tends — given price stability — to narrow as more of the property account becomes represented by additions made during more recent years at the prevailing higher prices, but there is always some lag.

In addition, numerous companies use the LIFO (last-in, first-out) basis of inventory valuation, which is designed to reduce the influence of price fluctuations on earnings and gives an inventory book value below current market. Other assets such as investments often are carried below market. Sometimes a company's "intangible" assets — goodwill, patents, trade marks, etc. — are worth far more than its "bricks and mortar" yet are given no valuation on the balance sheet.

Often the underground reserves of oil and mining companies, their most valuable assets developed at great expense, are carried at only nominal book valuations. In some cases, industrial plants and other properties are acquired at fortuitous prices and put on the books at a fraction of real value. Discrepancies between book values and replacement costs are never uniform as between companies, and keep changing constantly.

For these various reasons, the value of net worth comparisons is often called into question.

Earnings Overstated or Understated?

In the computation of "net income," however, there are likewise numerous factors which impair the strict comparability of the figures. Yet no one has suggested doing away with such comparisons.

One item of continuing controversy is the size of charges against income for the depreciation and depletion of physical properties. Many business men, accountants, and economists have pointed out that depreciation charges, even under the more liberal rules permitted since 1954, are still inadequate in the light of soaring replacement costs; that the earnings as reported are to that extent overstated.

On the other hand, George Meany, president of the AFL-CIO, charged not long ago that corporate earnings have been understated, because business has written off excessive depreciation. This charge is an admission, indirectly, that corporate assets are understated — in other words, that the historical costs of plant and equipment have been written down to balance sheet valuations well below current values. Yet Mr. Reuther, in his profit-sharing proposal, considers all earnings over 10 per cent (before taxes) as "excess" profits to be split up among labor, management, shareholders, and car buyers.

Notwithstanding these qualifications, the widely circulated reports of leading companies remain the only current source of earnings data available and are indispensable in determining the impact of economic changes upon the ability of business to make a living and build for the future. Primarily, the limitations to comparability of statements arise from inflation and the drop in purchasing power of money. No accounting system based in part on historical costs can state earnings or assets accurately unless there is a stable currency.

Zuppa to Zabaglione

Italian coffee for two puts a fascinating finish to a thoroughly enjoyable dinner at one of New York's most interesting restaurants. Dining well, like so many of the leisurely pleasures of life, calls for a relaxed and worry-free frame of mind.

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